

CAPITAL PROJECTS AND BOND OVERSIGHT COMMITTEE

Minutes

April 10, 2006

The Capital Projects and Bond Oversight Committee met on Monday, April 10, 2006, at 9:00 AM, in Room 316 of the Capitol. Representative Mike Denham, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Representative Mike Denham, Co-Chair; Senator Elizabeth Tori, Co-Chair; Senators Tom Buford and Jerry Rhoads; and Representatives Paul Marcotte and Jim Wayne.

Guests testifying before the Committee: John Hicks, Governor's Office for Policy and Management; Jim Abbott, Finance and Administration Cabinet; Lieutenant Colonel Shelby Lawson, Kentucky State Police; and Tom Howard, Office of Financial Management.

LRC Staff: Mary Lynn Collins, Nancy Osborne, Bart Hardin, Kristi Culpepper, and Shawn Bowen.

Senator Tori made a motion to approve the minutes of the March 15, 2006 meeting as submitted. The motion was seconded by Representative Marcotte and passed by voice vote.

Representative Denham called on Ms. Mary Lynn Collins, Committee Staff Administrator, to review correspondence and information items included in members' folders. Ms. Collins said the folders included four items of correspondence: follow-up correspondence from the Department for Facilities and Support Services in response to questions raised by the Committee at its March meeting regarding Steelo, the roof manufacturer for the McDowell Rehabilitation Center for the Blind; the semi-annual report of the Kentucky Asset/Liability Commission; quarterly status reports on authorized capital projects from the Finance and Administration Cabinet, Murray State University, University of Kentucky, University of Louisville, Western Kentucky University, and the Administrative Office of the Courts; and the Kentucky Lottery Corporation's monthly financial report for February 2006.

Ms. Collins said three information items were also included in members' folders: a staff update on various capital projects; proposed legislation relating to the jurisdiction of

the Capital Projects and Bond Oversight Committee; and the updated monthly and weekly debt issuance calendar.

Representative Wayne referred to a portion of the staff update that noted the roof on the Kentucky History Center is being replaced. He asked why the roof is being replaced on a facility that is relatively new. Mr. Jim Abbott, Commissioner for Facilities and Support Services, Finance and Administration Cabinet, said there have been issues relative to the installation and design of the roof, as well as issues concerning the materials used to construct the roof. He said this combination of problems has made it very difficult to determine who should be held solely responsible for the roof repair, and as such, the Finance Cabinet thought the most appropriate action was to use the remaining available project funds and fix the problems associated with the roof.

Representative Denham asked Mr. John Hicks, Deputy State Budget Director, Governor's Office for Policy and Management, and Mr. Abbott to present the Finance Cabinet's monthly report to the Committee. Mr. Hicks reported a \$4,286,000 restricted funds scope increase for the Northern Kentucky University (NKU) Regional Special Events Center project, and said the 7% scope increase is necessary to complete the facility, maintaining the size, and with the amenities needed for the project. The reason cited for the cost overrun was the increased cost of materials. Mr. Hicks said the University will generate the funds to cover the scope increase through revenue it will earn from a contract for exclusive rights for concessions and ticket management. In the event that the University cannot generate the full \$4,286,000 for the scope increase, the University will use its own funds without raising student fees. Mr. Hicks said, based on careful study of all cost reduction possibilities and performing value engineering with the construction manager, the NKU project staff think the scope increase is appropriate.

Representative Denham asked if the Finance Cabinet is concerned that the cost estimates used for other projects authorized by the 2005 General Assembly also did not adequately take into account the rising costs of building materials. Mr. Abbott said the estimates they have presented to the Committee reflect current costs. He said this project is being bid in a number of different packages, the first being site clearing and grading in May. He said the project will take a long time to complete. With the scope increase requested, they anticipate being in good shape.

Representative Denham said in his district the cost of construction materials has escalated and many contractors have moved south to work due to Hurricane Katrina. He asked Mr. Abbott if this was happening with other projects. Mr. Abbott said this was a concern, and they have seen some increases in materials costs. However, their experience is varied. Some recent projects have come in over scope, some have come in on budget, and a few have come in below budget. He said they believe the full impact of Hurricane Katrina has not yet been felt. Mr. Abbott said some of the projects that were bid out early

went out at a good time. He cited the State Office Building project as an example, a project in which the bid came in under the estimated scope by approximately \$8 million.

Mr. Hicks next reported a scope increase for the Kentucky State Fair Board project, Renovate East Wing/East Hall. This project was authorized in the 2004-06 budget at a scope of \$55,000,000. Mr. Hicks said bids for this project were opened approximately one month ago and a scope increase of \$3,405,500 (6.2%) is needed to accept bid alternate one to build a north lobby pedestrian connector above the East Wing. The funding source for the scope increase is the remaining balance in the earlier South Wing Expansion/Renovation project, which was authorized in the 2002-04 budget for \$52 million in agency bonds.

Mr. Hicks then reported a scope increase for the Glasgow State Nursing Facility Structural Repair project. This emergency project was reported to the Committee in January 2006 at a scope of \$450,000. Mr. Hicks said the structural repair is going well, but an additional \$45,000 is needed to fully fund the shoring design that was underestimated in January. The source of funds for this increase is the Cabinet's bond funded maintenance pool.

The final item Mr. Hicks reported was a \$200,000 scope increase for the Kentucky State Police (KSP) to upgrade its statewide communications system. This project is part of the KSP Homeland Security Communications Project I, which was established as an unbudgeted project at a scope of \$2,896,100 (federal homeland security funds). The project will increase the interoperability of systems between KSP, local police forces, and emergency responders. Mr. Hicks said KSP has been awarded \$200,000 in federal homeland security funds to purchase other equipment associated with the implementation of the project.

Representative Denham asked if this system will help local first responders in rural and remote areas communicate with each other. Lieutenant Colonel Shelby Lawson, Director of Technical Services, KSP, said this project is designed to help all first responders communicate with each other. He said this project will help first responders in those first critical moments when everybody is responding to an incident. He said once they are on scene, the agencies can use their own radio systems for intra-agency communication.

Representative Denham asked if the agencies needed to apply for grants from the federal government for communications assistance. Lt. Colonel Lawson responded that some of the agencies would need to apply for these grants. He said some of the federal grants and a lot of the homeland security grants are designed to enhance an agency's intra-agency communication ability, and Homeland Security has been flexible in funding those projects as long as they are geared towards interoperability.

Representative Denham said he appreciated KSP's attention to this problem which is critical in rural areas.

In response to a question from Senator Tori, Lt. Colonel Lawson said the Center for Rural Development is administering the KSP Homeland Security Communication project, but it is a statewide project that will encompass all 120 counties in the state. He said this federal funding is unexpected and came at a opportune time when old equipment needs to be upgraded. He said KSP had to purchase 800 megahertz base stations and erect some 800 megahertz towers to cover the Northern Kentucky where the KSP does not normally utilize 800 megahertz frequencies.

Representative Marcotte made a motion to approve the scope increases for the NKU Regional Special Events Center project, the Kentucky State Fair Board Renovate East Wing/East Hall project, and the Kentucky State Police Homeland Security Communications project. The motion was seconded by Representative Wayne and passed by unanimous roll call vote. No action was required on the fourth project, the structural repair project at Glasgow State Nursing Facility, since this project is an emergency.

Representative Denham asked Mr. Abbott to update the Committee on the Bert T. Combs Forestry building in Pineville at its May meeting.

Ms. Collins said members' folders included a 2020/Fund B Grant for the Larue County Water District and various line-item Coal/Tobacco Development Grants approved in the 2004-06 budget. Representative Denham said no further action was required on these projects.

The next report was provided by Mr. Tom Howard, Executive Director, Office of Financial Management (OFM). Mr. Howard presented two new school bond issues with School Facilities Construction Commission (SFCC) debt service participation for Ludlow Independent (Kenton Co.) and Madison County.

Senator Tori made a motion to approve the two school bond issues. The motion was seconded by Representative Wayne and passed by unanimous roll call vote.

Ms. Collins said there were two locally-funded school bond issues submitted to the Committee for review this month for Daviess County and Pulaski County. She said all disclosure information has been filed, and no further action on the bond issues is required.

Representative Marcotte noted that Moody's rating carries a negative outlook for Kentucky. He asked Mr. Howard to explain what a negative rating would mean for the state and what the anticipated bond rating would be if the proposed conference report on the Executive Budget passed later in the day.

Mr. Howard said the appropriation supported debt of the General Fund is rated Aa3 with a negative outlook by Moody's. Fitch has rated it AA- with no expression and S&P has rated it A+ stable. Mr. Howard said Moody's has expressed some concern in a variety of areas for the state. The major categories they look at are the stability of revenue streams, the diversity of those revenue streams, how those match up against the expenditures, and the structural balance between recurring revenues and recurring expenditures. Moody's also looks at the amount of reserves the state has available and the flexibility if revenues do not come in as expected, the amount of debt the state has, and the management and implementation plans that go along with the debt process, as well as making necessary cuts in times when revenues and expenditures get out of alignment for economic reasons. Mr. Howard said he has not seen the budget developed by the full conference committee, so it would be premature for him to comment on what it might or might not do in relation to the bond ratings.

Representative Wayne noted the debt load in the current budget is heavier than last year's budget. He asked if it is likely that Moody's will take another look at the state's bond rating and if the state may be in a worse position. Mr. Howard said he could not comment on the nature of the budget developed in conference since he had not seen it. He said Moody's looks at every budget the state passes and goes down each of those factors and takes those into consideration in arriving at its outlook and credit rating.

In response to another question from Representative Wayne, Mr. Howard said if the state were to have a single A rating across the board, a lower credit rating than it had at the end of 2005, it would cost the state an extra 20 basis points, which translates into approximately \$40 million in extra interest costs, based on \$1 billion of debt.

Representative Denham asked how the rise in interest rates will affect the state's debt and interest payments. Mr. Howard said prior to each session his office is asked to look forward at arriving at a debt service template rate that is suggested to the General Assembly for appropriating debt service to make sure all projects can adequately be funded. He said right now they see a flattening of the yield curve, so long term rates have not gone up as much, although they are starting to go up some as of late last week. Mr. Howard said they have also entered into interest rate hedges for the forward sale of bonds so they can lock in an interest cost that would be about 4.5% on \$3 million of the existing authorization.

With there being no further business, Senator Buford made a motion to adjourn the meeting. The motion was seconded by Representative Wayne, and the meeting adjourned at 9:35 a.m.